

BILL ANALYSIS

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Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	Hill	ABX6 11

SUBJECT

Disaster Loss/San Mateo County Explosion and Fire

SUMMARY

This bill would allow special tax treatment, called disaster loss treatment, for losses sustained as a result of the explosion and fire that occurred on September 9, 2010, in San Mateo County.

This analysis will not address the bill's changes to the Property Tax Law, as they do not impact the department or state income tax revenue.

PURPOSE OF BILL

According to the author's office, the purpose of this bill is to provide immediate tax relief to individuals and businesses affected by the explosion and fire.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

ANALYSIS**Disaster Losses and Casualty Losses**

Under federal law, a disaster loss is defined as business or personal property that is completely or partially destroyed as a result of a fire, storm, flood, or other natural event in an area declared to be a disaster area by the President of the United States. For state purposes, a disaster loss is defined the same as federal law but is declared to be a disaster area by the President of the United States, the Governor or both.

A casualty loss is defined as the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

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Disaster Loss Treatment

Existing federal and state laws allow an individual taxpayer with a disaster loss that is not reimbursed by insurance or otherwise to deduct such losses to the extent that each loss exceeds \$100 and aggregate losses for the taxable year exceed 10 percent of adjusted gross income.¹ Additionally, disaster loss treatment allows a taxpayer to make an election to claim the disaster loss by filing an amended return for the taxable year prior to the loss to receive a refund more quickly; however, this election applies automatically only to disaster losses occurring in a Presidentially-declared disaster area. The election is not available for Governor-only proclaimed disasters until enabling state legislation has been enacted.

Under existing federal law, the deadline to make an election to file an amended return is the original due date to file a return for the taxable year in which the disaster occurred.

Federal and state law also state that a casualty or disaster loss is not sustained under Internal Revenue Code section 165 until it can be ascertained with reasonable certainty whether or not a reimbursement will be received from other sources, such as insurance or an adjudicated claim.

State law must be enacted for each disaster to allow taxpayers to make the election to file a prior-year amended return, which for most individuals is by October 15th (the extended due date of the original return for the taxable year in which the disaster occurred). The extended due date for corporations varies based on each corporation's fiscal year. The election is made by the act of filing the amended return claiming the disaster loss.

State law must be enacted for each disaster, whether declared by the President or proclaimed by the Governor or both, to allow disaster losses to be carried forward (deducted) in excess of the amount that can be claimed on the prior year return or the original return for up to 15 taxable years.

Federal – Net Operating Losses (NOLs)

When a taxpayer has a net operating loss for a taxable year, the operating loss that may be deducted in subsequent years is called a NOL. An operating loss occurs when a taxpayer's allowed deductions exceed their gross income for that year. Federal law provides, in general, that an NOL can be carried back 2 years and forward 20 years and deducted. Special rules are provided for the carryback of NOLs relating to issues such as specified liability losses, casualty or theft losses of individuals, disaster losses of a small business, and farming losses. For NOLs arising in tax years ending after December 31, 2007, an eligible small business can elect to increase the NOL carryback period for an applicable 2008 or 2009 NOL from 2 years to 3, 4, or 5 years.

¹ For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

State – NOLs

In general, a California taxpayer calculates its NOL in accordance with federal rules. For NOLs attributable to taxable years beginning before January 1, 2008, California limits the carryforward period to 10 years in circumstances where federal law allows 20 years. For NOLs attributable to taxable years beginning before January 1, 2011, NOL carrybacks are disallowed.

NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2011, with the following modifications:

1. An NOL may be carried back only 2 years. (Federal law has special rules that in some cases allow an NOL to be carried back for a longer period).
2. The amount of NOL carryback attributable to taxable year 2011 is limited to 50 percent of the NOL.
3. The amount of NOL carryback attributable to taxable year 2012 is limited to 75 percent of the NOL.

Current state law conforms to the federal carryback period for a Real Estate Investment Trust and a corporate equity reduction interest loss, which is zero.

NOLs deductions are suspended for taxable years 2008 and 2009 for a taxpayer with net business income (PITL²) and income subject to tax (CTL³) of \$500,000 or more. However, deductions for NOL carrybacks from taxable years beginning on or after January 1, 2011, would be allowed.

For PIT, “net business income” means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S Corporation), income from rental activity, and income attributable to a farming business.

When state legislation is enacted for disaster loss treatment, the rules for NOLs do not apply, and the taxpayer must claim their losses arising from a disaster loss using the disaster loss treatment.

PROGRAM BACKGROUND

Acting Governor Abel Maldonado proclaimed on September 10, 2010, a state of emergency declaring the explosion and fire that occurred in San Mateo County on September 9, 2010, to be a state disaster. President Obama did not declare this explosion to be a federal disaster.

² Personal Income Tax Law.

³ Corporation Tax Law.

THIS BILL

This bill would add sections to the Personal Income Tax Laws (PITL) and Corporate Tax Laws (CTL) under the Revenue and Taxation Code (R&TC) that would allow special disaster treatment of losses sustained as a result of the explosion and fire that occurred in San Mateo County on September 9, 2010.

Specifically, this bill would allow taxpayers affected by the explosion to do the following:

- Elect to file an amended return for the prior taxable year to deduct the disaster loss and reduce the prior year tax liability, resulting in a refund; and
- Allow carry forward treatment for up to fifteen taxable years for losses sustained as a result of the explosion and fire.

Losses sustained to non-business property as a result of the explosion would have to be greater than the \$100 and the 10 percent of AGI limitations to qualify for disaster loss treatment.

IMPLEMENTATION CONSIDERATION

This bill would allow taxpayers to carry an applicable percentage of the remaining excess disaster losses forward for ten years after the five-year period in which the losses are normally allowed. The applicable percentage is determined by reference to paragraph (1) of subdivision (b) of Section 17276 under the PITL and to paragraph (1) of subdivision (b) of Section 24416 under the CTL. A recently enrolled budget trailer bill (SB 858, Committee on Budget and Fiscal Review, 2009/2010) would repeal R&TC sections 17276 and 24416 and add new sections 17276.20 and 24416.20. Without language protecting the intent to allow 100 percent of excess disaster losses for a total of 15 years, taxpayers may only be able to deduct 100 percent for five years.

LEGISLATIVE HISTORY

AB 50 (Nava, 2009/2010) would have allowed taxpayers disaster loss treatment for losses sustained as a result of the wildfires that occurred in Placer County during August 2009. AB 50 failed to pass out of the Senate.

AB 1662 (Portantino, et al., Stats. 2010, Ch. 447) allows special tax treatment, called disaster loss treatment, for losses sustained as a result of the August 2009 Los Angeles and Monterey Counties wildfires and the January 2010 Calaveras, Imperial, Los Angeles, Orange, Riverside, San Bernardino, San Francisco, and Siskiyou Counties winter storms.

AB 1690 (Chesbro, Stats. 2010, Ch. 449) allows special tax treatment, called disaster loss treatment, for losses sustained as a result of the January 9, 2010, Humboldt County earthquake.

AB 1766 (Gaines, Stats. 2010, Ch. 364) allows special tax treatment, called disaster loss treatment, for losses sustained as a result of the August 2009 Placer County earthquake.

AB 1782 (Harkey, 2009/2010) would have provided automatic special tax treatment, called disaster loss treatment, for losses sustained as a result of any governor-declared state of emergency. AB 1782 was held in the Assembly Revenue and Taxation Committee.

AB 2136 (V. Manuel Perez, et al., Stats 2010, Ch. 461) allows special tax treatment, called disaster loss treatment, for losses sustained as a result of the April 2010 Imperial County earthquake.

ABX8 31 (Portantino/Jeffries, 2009/2010) would allow special tax treatment, called disaster loss treatment, for losses sustained as a result of the August 2009 Los Angeles County wildfires. ABX8 31 failed to pass prior to the adjournment of the eighth special session of 2009/2010.

SB 858 (Committee on Budget and Fiscal Review, 2009/2010) would, among other things, make the federal disaster NOL carryback rules inapplicable for state purposes, delay the operative date for NOL carrybacks, and suspend NOL deductions for two years. SB 858 was enrolled on October 8, 2010.

SBX 6 21 (Yee/Hill, 2009/2010) was identical to this bill. SBX6 21 failed to pass out of the Senate.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

It is assumed that all affected taxpayers will file claims and receive reimbursement from PG&E for losses sustained as a result of the explosions and fire. Therefore, there would be no deductible loss to result in a revenue impact. If it is later determined that some of the losses will not be reimbursed, the taxpayers may deduct the loss under the disaster loss rules at that time. It is expected that the revenue impact at that time would be minimal.

Support/Opposition

None reported.

VOTES

Assembly Floor – Ayes: 73, Noes: 0

Senate Floor – Ayes: 34, Noes: 0

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